

Bank of England

Digital Securities Sandbox (DSS)

Gate 1 webinar – Q&A responses

Financial Market Infrastructure Directorate

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Foreword

On Tuesday 19 November 2024, the Bank and the FCA hosted a webinar to provide an overview of the DSS, including the eligibility criteria to enter the Sandbox – the Gate 1 assessment.

As part of that webinar, attendees submitted questions to the presenters. This document provides a summary of those questions, and written responses, including those that were not answered during the webinar.

Please note that some questions have been edited for clarity.

Questions and answers

Eligibility Criteria

1. Am I required to highlight a regulatory barrier even in cases where the activity is voluntarily being tested inside a regulatory framework?

The Bank generally requires applicants to identify the regulatory or legal barriers and/or obstacles to using developing technology such as DLT which in the view of the applicant prevent them from operating their optimal business model outside of the DSS. The regulators have become aware of certain use cases (such as fund tokenisation) which it may be possible to implement in compliance with existing laws and regulations. But, it may be advantageous to test these use cases within the DSS in order to observe the risks and benefits and to consider the future regulatory and legal regime applicable to them, including where the regulatory perimeter should be set in the future.

In such cases the regulators will consider applications even where the relevant activity could lawfully be carried on outside the DSS, given the existing regulatory perimeter. Applicants with such use cases should still make it clear in their application what the benefit of operating inside the DSS would be.

2. Will existing Financial Market Infrastructures (FMIs), which currently carry out trading and settlement activities, be eligible to apply for the DSS? If they scale through the DSS and DLT is the chosen technology, would they need to re-platform?

All firms that meet the eligibility criteria can apply to enter the DSS, regardless of their existing activity or FMI status. Firms would need to comply with any requirements to separate DSS activities from other existing activities, as necessary.

3. How you are approaching similarly regulated firms under DLTR in the EU. Is there the possibility for a "fast-track" in the application process for a DLT market operator as part of the DSS?

The DSS has separate eligibility requirements to the EU Pilot Regime, and there is no equivalence in place between the two regimes. Therefore, firms would need to apply based on the relevant criteria and be assessed separately.

Firms that are already authorised to operate in the EU Pilot Regime may be more advanced in their operations than other firms, and therefore be better placed to demonstrate their ability to meet the criteria at the relevant Gates. However, there is no fast-track process in place for these firms.

4. Is it possible to provide access to retail clients?

For firms seeking to operate a DSD in the DSS (whether as a standalone DSD or as part of a hybrid entity), a firm may apply if it has a retail client focus. However, the Bank would need to carefully consider how this might impact the levels of protection offered to retail investors using DSD services. Given there may be potential for different and additional risks for non-professional clients were they to access DSDs directly (relative to the ways such users currently access FMIs utilising tested technologies), additional scrutiny will need to be applied where DSS participants propose direct retail access to a DSD. This would mean that decisions on Gate 2 applications in particular would take longer where they relate to services to be offered to retail investors.

For firms seeking to operate a trading venue in the DSS, the FCA does not consider the current framework to rule out direct retail participation, provided that operators comply with the existing regulatory FCA frameworks.

5. Is there a limitation as regards the type of the DLT used (i.e. permissionless, permissioned, private/public)?

The regulators are taking a permissive approach to using new technology in the DSS. However, like all applicants to the DSS, firms using permissionless blockchains as a core part of their infrastructure or linking to permissionless blockchains will need to demonstrate to the regulators that their proposed use of such technology meets the required regulatory outcomes. More detail on this is available on the [Bank's dedicated Gate 2 webpage](#).

6. Will the assets in scope be reviewed/expanded at any stage?

The scope of assets is set based on those that are already under regulations - specifically the Regulated Activities Order (RAO). Derivatives are excluded and legislation relevant to derivatives (such as MIFIR) are not amended in the DSS.

If changes are made to the RAO, then regulators will give due consideration to their use in the DSS. We also welcome dialogue with firms on other asset classes that could be considered.

DSS Fees

7. Do the fees increase with every gate passed? Would it not make sense to set fees proportionate to the size of the firm and volume of risk?

The fees for Gate 1 and Gate 2 are as follows:

Gate 1 - £10,000 fee payable on application

Gate 2 - £40,000 fee payable on successfully passing Gate 2 process

These fees reflect the amount of work for regulators to complete these Gate 1 and Gate 2 assessments.

The resources required to support the DSS are not solely dependent on the level of activity at each specific firm. In line with our approach for charging fees to existing FMI, firms will be charged the same amount on an annual basis. This may vary for hybrid firms where there is overlap between DSS activity and other (FCA) regulated activity that fees are levied for.

Gate 2

8. Are there any (ongoing) further requirements for applicants e.g. capital requirements, ownership control processes etc. when it comes to live activity?

The requirements for firms at “Go-Live” are set out in our Gate 2 rules. We strongly advise firms to review these in advance of applying for Gate 1.

Regulators will meet with firms as part of the Gate 2 application process to discuss any outstanding questions relating to these topics.

9. We plan to run a hybrid model, but the DSD element can stand alone and would be ready to go live prior to the trading venue component. The DSD component could be used in conjunction with other entrants or those outside the sandbox (per the guidelines). Is it possible to advance to Gate 2 for the DSD component in advance or readiness for a complimentary trading venue at a later time?

For hybrid firms, it is possible to complete the Gate 2 process for the DSD separately from the trading venue approval. We advise that firms make this clear when starting the Gate 2 process to enable regulators to resource the application appropriately.

10. Will support be provided to firms if they progress past Gate 1 to help progress through subsequent gates?

In addition to guidance accompanying the Gate 2 application and webinars covering Gate 2 (found on the [Bank’s dedicated Gate 2 webpage](#)), regulators will be engaged with firms throughout the Gate 2 process and commit to holding 3 hours of pre-application meetings to discuss requirements. However, firms will be expected to digest the Gate 2 requirements and submit proposals for review, rather than consulting with regulators on an ongoing basis.

11. You have laid out general timelines that you expect per gate. Would you elaborate on how you see timelines progressing per gate?

Although the Bank has not set a time by which the approval of an application at Gate 2 must be determined, it aims to assess DSD applications against Gate 2 rules within four months. However, where applications are incomplete, or there are delays in producing further information required for the assessment, these timeframes will be longer. As above, a high-quality, considered application and timely, open communication thereafter is the most effective way to ensure an assessment within the suggested timeframes. We expect that application review times will vary from firm to firm.

Unlike at Gate 2, the Bank will open a window to receive Gate 3 applications – known as the Gate 3 review point. This will be at an appropriate time after the Gate 3 rules are published. These review points are created to allocate capacity fairly in the DSS, and the first review point will likely be open 15-18 months after the DSS was opened for applications. DSDs that miss this review point will need to wait for a subsequent review point.

Payment Leg

12. What are the expectations for the payment aspects of the DSS, where the firm is not itself a credit institution. Specifically, for non-GBP denominated digital assets, do the regulators have specific expectations as to the currency of the payments? Can the firm use payment rails provided by a non-UK (e.g. EU) credit institution that is regulated as a credit institution in the relevant country? (Please assume a broadly equivalent regime such as EU.)

There are no specific restrictions on the currency of payments, provided the form of money used meets the requirements of the DSS - that is, central bank or commercial bank money.

Payment rails can be provided by any firm that is authorised to process payments in that currency and/or jurisdiction.

We will consider waivers to allow non-UK banks to provide non-GBP payments services as necessary.

13. Could you please explain the regulators' expectations on settlement instruments. Is there appetite to see tokenised deposits (distinct from stablecoins), or do you prefer to see off-chain fiat for settlement purposes - you mentioned "provided the form of money meets the requirements set out"?

Settlement needs to take place in central bank or commercial bank money. For example, tokenised deposits, off-chain fiat (i.e. 'traditional' rails), and use of Bank of England omnibus accounts are all acceptable settlement mechanisms. Stablecoins or e-money are not considered acceptable forms of money for settlement due to the

financial stability risks that their use may involve. This exclusion also applies to stablecoins or e-money tokens regulated in other regimes outside of the UK.

Engagement and Outcomes

14. How many Entrants have applied for DSS so far? Will firms accepted as DSS entrant be listed publicly automatically or by choice as accepted into DSS?

Regulators publish the Sandbox Approval Notices of the firms that have passed Gate 1 applications on the [DSS Dashboard](#).

Regulators have committed to transparency about activity in the DSS, including how the overall capacity is used by firms.

15. If multiple firms are welcomed to test innovative technologies for trading and settlement of traditional securities in the DSS, would there be multiple trading and settlement entities if these firms successfully go through the DSS? Or will there be a streamlined system with one entity for traditional securities?

The DSS is designed to help determine what changes are needed to the UK's securities settlement regulations to support innovative approaches and technologies. The regulations today permit for multiple providers of securities systems, and if there are multiple successful firms in the DSS, we would expect all to be able to graduate to the permanent regime.

16. Will there be any collective entrant engagements overseen by the BoE/FCA to help firms compliment other entrants in the cohort?

The regulators intend to set up a forum for firms that have entered the DSS. The structure and objectives of this forum will be communicated in due course.